Nos. 15757, 15758, 15759

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeals From the Judgments of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEE.

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BRIEF FOR THE APPELLEE.

Opinion Below.

The findings of fact and conclusions of law of the District Court [R. 29-44] are not officially reported.

Jurisdiction.

These appeals[1] involve federal income taxes. The Commissioner of Internal Revenue determined deficiencies in income tax in years and amounts as follows [R. 36]:

	1945	1946	1947
Laurence V. Kanter	$ 803.72	$3,488.64	$5,492.62
Jerome B. Kanter	375.32	2,461.23	3,624.74
Ruth Kanter Wolins	1,129.30	4,482.70	8,278.77

These amounts were paid by the respective taxpayers and on or about August 12, 1950, timely claims for refund were filed seeking refund of a portion of the above deficiencies plus interest in the following amounts [R. 36]:

	1945	1946	1947
Laurence V. Kanter	$ 794.05	$3,302.73	$4,553.55
Jerome B. Kanter	375.32	1,956.41	2,751.18
Ruth Kanter Wolins	869.20	3,567.13	5,346.20

These claims were either formally disallowed by the Commissioner or no action was taken by the Commissioner for six months. [R. 9-10, 12, 15.]

Thereafter within the time provided in Section 3772 of the Internal Rveneue Code of 1939 and on April 3, 1953, taxpayers brought actions in the District Court for the Southern District of California for recovery of taxes paid in the amounts stated in the refund claims. [R. 3-12.] Jurisdiction was conferred on the District

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[1]Because of the identity of factual and legal issues the three cases have been consolidated on appeal and only the record in *Laurence V. Kanter v. United States* (No. 15757) has been printed with leave reserved to refer to the certified record in the other two cases on brief and argument. [R. 87-90.]

Court by 28 U. S. C., Section 1346. The judgments were entered on July 29, 1957. [R. 45.] Within sixty days and on September 19, 1957, notices of appeal were filed. [R. 46.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Whether the District Court erred in finding that the income of three trusts of which taxpayers were beneficiaries was properly included in taxpayers' gross income for the taxable years involved, such trusts, lacking in substance and reality, having been created solely as a tax minimization device?

Statute and Regulations Involved.

The pertinent sections of the applicable statute and Regulations are set forth in Appendix, *infra*.

Statement.

The basic facts as found by the District Court [R. 30-43] were either stipulated by the parties [R. 17-27, 73-75, 76-81] or are based on exhibits introduced in evidence. [R. 47-81.] They are summarized below.

During the early part of 1944 the Kanter family consisted of Harry L. Kanter, his wife, Minnie Kanter, and their three adult children, taxpayers Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins. The family operated a chain retail food and liquor business under the name of Shop 'N Save, a California corporation. The three children each owned 6.81% of the stock; the father owned 13.31% and the mother owned the remaining 66.26%. [R. 31.]

During the early part of 1944, the stockholders agreed to terminate the corporation and form a limited partnership to conduct the identical business then being conducted in corporate form. At the same time the mother, Minnie Kanter, decided to make a gift of a portion of her interest in the business to each of her children (taxpayers). In order to reduce the taxes that her children would have to pay on the proposed gift, Minnie Kanter conveyed a 6.81% interest in the family business in trust for each child. In all respects as to Minnie Kanter the gifts were valid since she effectively parted with control and paid a gift tax on the transfers. [R. 31.]

The three trusts are referred to throughout in terms of the chief beneficiary. Under each trust instrument there were at least two secondary beneficiaries who had an interest contingent on the death of the primary beneficiary before January 2, 1960, without lawful issue or spouse surviving. The trustees, their relationship to the beneficiary and the secondary beneficiary of each trust are as follows [R. 32]:

Trustees	Secondary Beneficiaries
Laurence V. Kanter Trust	
Ruth Kanter Wolins (sister)	Jerome B. Kanter
Albert Wolins (brother-in-law)	Ruth Kanter Wolins
Jerome B. Kanter Trust	
Ruth Kanter Wolins (sister)	Ruth Kanter Wolins
Laurence V. Kanter (brother)	Laurence V. Kanter
Ruth Kanter Wolins Trust	
Albert Wolins (husband)	Albert Wolins if surviving; otherwise,
Laurence V. Kanter (brother)	Laurence V. Kanter
	Jerome B. Kanter

Although not referred to in the findings of fact it appears that taxpayer Jerome B. Kanter was in the armed forces when the trusts were created. [Ex. 1-E, R. 70.]

On or about April 1, 1944, the corporation, Shop 'N Save, was partially liquidated and a limited partnership under the same of Kanter & Wolins was organized to conduct the same business. This had been in contemplation prior to the execution of the trusts. On the partial liquidation the shares of capital stock held by the shareholders were cancelled in exchange for interests as limited partners in the assets and profits of Kanter & Wolins. The shares of capital stock which were to have been placed in the corpus of each trust executed by Minnie Kanter were thus cancelled and the value of the corpus of each trust was credited to the capital account of each trust on the books of the partnership. No separate books were kept for the trusts and transactions affecting the trusts were reflected only in the capital accounts of the trusts as limited partners on the books of the partnership. [R. 32-33.]

Pursuant to the agreement of limited partnership entered into on March 31, 1944 [R. 64-71], a Certificate of Limited Partnership [R. 58-63] was executed and filed with the Los Angeles County Recorder on April 1, 1944. The general and limited partners, their capital investments and percentage ownership are as follows [R. 34]:

General Partners	Capital Investment	Per Cent of Capital and Profits
Harry L. Kanter	$ 31,058.00	13.31%
Laurence V. Kanter	15,910.00	6.81%
Albert L. Wolins	10,600.00	4.54%
Limited Partners		
Minnie F. Kanter	105,894.00	45.37%
Jerome B. Kanter	15,900.00	6.81%
Ruth Wolins	5,300.00	2.27%
Trust No. 1 (for Jerome B. Kanter)	15,900.00	6.81%
Trust No. 2 (for Laurence V. Kanter)	15,900.00	6.81%
Trust No. 3 (for Ruth Wolins)	15,900.00	6.81%
Trust No. 4 (for Sue Ellen Wolins)	1,060.00	.46%

The capital investment of each partner consisted of his stock in Shop 'N Save. Although there was no restriction on the right of a general partner to assign all or a portion of his interest in the partnership, the agreement expressly prohibited assignment of the interest of a limited partner. [R. 34-35.]

The trust instruments in question gave broad powers of investment and management of the corpus to the trustee. The term of each trust was 15 years and 10 months divided into three periods, A, B and C, ending on January 2, 1950, 1955 and 1960, respectively. The accumulated income of each trust was to be distributed at the end of periods A and B, and all accumulations and

the corpus to be distributed at the end of period C, the terminal date of the trusts. [R. 37-38.]

The trustees had discretion to distribute income to the beneficiary at any time as follows [R. 38]:

> In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation.

Between April 1, 1944, and January 2, 1950, the end of period A, the captial account of each trust in the books of the partnership increased from $15,900 to over $43,000 by reason of the crediting of annual partnership income thereto. Despite the express provision of the trust instruments, this income of the trusts was not distributed on January 2, 1950, but was retained in the partnership. [R. 38-39; 42-43.]

On January 9, 1950, the partnership exchanged substantially all of its assets for all the common stock in a newly-formed corporation, McDaniel's Markets. Despite the fact that this corporation consistently lost money and subordinated the common stock by obtaining outside capital through issuing preferred stock, the trustees permitted the corpus to remain invested in that business. [R. 39-43.]

The Commissioner of Internal Revenue determined that the income of the trusts for the years 1945, 1946 and 1947 was properly taxable to the chief beneficiary of each trust and asserted deficiencies in tax on that theory. After payment of the deficiencies and rejection of their

refund claims taxpayers brought the present suits for the refund of the portion of the deficiencies caused by the inclusion of trust income in their individual incomes. [R. 36.]

The District Court approved the Commissioner's determination and concluded that the creation of the trusts was solely a tax minimization device lacking substance and reality and that the Commissioner was correct in including trust income in the taxable income of taxpayers. [R. 42, 44.]

Summary of Argument.

It is the Government's contention that the trusts in question when viewed in light of all the surrounding circumstances were correctly found to be illusory. The facts disclose that while the grantor made a valid gift to each taxpayer of a share of the family business, the form of the gifts, in trust, was intended from the outset to have validity for tax purposes only. This is demonstrated by the unique business and familial interrelationships of the trustees and beneficiaries and the fact that the trusts were never regarded as anything more than a tax minimization device by the parties directly involved. Further, subsequent events prove this beyond any doubt since the fiduciary duties and mandatory directions of the trust instruments were totally ignored.

The applicable decisions make it clear that when a beneficiary of a trust can receive any or all of the trust income at his own option, he is taxable on the entire income whether distributed or not. The income is thus taxable to the taxpayers under the mandate of Section 22(a) of the Internal Revenue Code of 1939.

ARGUMENT.

The Decision of the District Court That the Trusts in Question Were Illusory and Should Be Disregarded for Income Tax Purposes Was Correct and Should Be Affirmed.

The issue in these cases is whether the District Court erred in finding that the taxpayers were taxable on the undistributed income of three trusts of which they were the beneficiaries. There appears to be little dispute as to the applicable rule of law, the taxpayers on brief summarizing it as follows (p. 23):

> Where income is subject to one's unfettered command during the taxable year and he is free to enjoy it at his own option, he may be taxed on such income whether he elects to enjoy it or not.

To this proposition we can only add that in determining whether the facts of a particular case meets this rule the courts are not limited by form or "the legal paraphernalia which inventive genius may construct", but judge the actual bona fides of the transaction giving "special scrutiny" where intra-family arrangements are involved. *Helvering v. Clifford,* 309 U. S. 331, 333; *Corliss v. Bowers,* 281 U. S. 376; *Helvering v. Horst,* 311 U. S. 112; *Helvering v. Eubank,* 311 U. S. 122; *Lucas v. Earl,* 281 U. S. 111; *Trousdale v. Commissioner,* 219 F. 2d 563 (C. A. 9th). Such income is includible in gross income under the provisions of Section 22(a) of the Internal Revenue Code of 1939, Appendix, *infra.*

The disagreement in this case would thus seem to be limited to the question of whether the trust income under consideration was actually subject to taxpayers' unfettered command as the District Court concluded. [R. 44.] This presents a question of fact for the trier to be resolved

by reference to all the surrounding circumstances. *Helvering v. Clifford, supra; Helvering v. Elias,* 122 F. 2d 171 (C. A. 2d); *Paster v. Commissioner,* 245 F. 2d 381 (C. A. 8th), certiorari denied, 355 U. S. 876. The findings of the District Court should not be disturbed unless clearly erroneous. Rule 52(a), Federal Rules of Civil Procedure. Nor does the fact that the cases were submitted on stipulated facts and exhibits justify *de novo* consideration as taxpayers suggest. (Br. 21.) In such cases this Court has said that "the ultimate question is whether the findings are supported by the record" and that "findings of fact shall not be set aside unless clearly erroneous." *Rollingwood Corp. v. Commissioner,* 190 F. 2d 263, 265, distinguishing *Pacific Portland Cement Co. v. Food Mach. & Cham. Corp.,* 178 F. 2d 541 (C. A. 9th), relied on by taxpayers. (Br. 21.) See also, *United States v. Gypsum Co.,* 333 U. S. 364, 394-395, rehearing denied, 333 U. S. 869; *Randall Foundation, Inc. v. Riddell,* 244 F. 2d 803, 805 (C. A. 9th); *Stockton Harbor Indus. Co. v. Commissioner,* 182 F. 2d 1010, 1013-1014 (C. A. 9th).

The District Court found that the creation of the trusts was a "tax minimization device" under which the "beneficiaries of the trusts had unlimited power and control over the corpus of the trusts" [R. 42], and concluded that the beneficiaries were the actual owners of the trust income. [R. 44.] It is submitted that there is ample support in the record for such findings.

At the outset it should be noted that tax avoidance was the only purpose and function of these trusts. Taxpayers have stipulated [R. 74] that the settlor's *"sole purpose* in executing these trusts * * * was to reduce the taxes that her children would have to pay on the income from

the property gifted by her." (Emphasis supplied.) While this fact alone is admittedly not determinative, it is certainly a pertinent part of total background and should not be ignored so as to "exalt artifice above reality." *Gregory v. Helvering,* 293 U. S. 465, 467. The obvious result of allowing the trusts to stand would be to recognize the existence of six taxpayers where only three would exist if the gifts were made outright. The resulting diffusion of income was apparently the only motive of the conveyance into trust.

The conceded tax avoidance motive does become important when combined with the reciprocal nature of the trusts and the business and familial relations of the parties. When Minnie Kanter, the grantor, established the trusts in 1944, the family business was operated as a corporation and was wholly owned by the Kanter family, with each taxpayer owning 6.81%, the father, Harry, owning 13.31%, and the mother, Minnie, owning the remaining 66.26%. [R. 31.] Minnie decided to give each child another 6.81% interest in the business and at the same time the form of doing business was to be changed from a corporation to a limited partnership. [R. 31.] If the trust arrangement had not been used, there is no question that the taxpayers each would have had to report 13.62% of the distributable partnership income whether received or not. Section 182, Internal Revenue Code of 1939, as amended by Section 150(g)(1)(B) of the Internal Revenue Act of 1942, c. 619, 56 Stat. 798. However, under the trust arrangement, if valid, each child would have to report as income from the trust only the amount that he actually received. Sections 161(a) and 162(c) of the Internal Revenue Code of 1939. (Appendix, *infra.*)

The obvious inference from the very recitation of the facts is that each beneficiary was to get whatever portion of trust income he or she wanted. There is no other explanation for the curious interrelationship of beneficiaries and trustees—*i.e.,* Laurence was at once trustee for his brother's and sister's trust and beneficiary of a trust administered by his sister and her husband; his sister, Ruth, was trustee for Laurence and Jerome and beneficiary of a trust administered by her husband and Laurence; Jerome was not a trustee, apparently because he was absent in the armed forces [R. 70], but his trust was exactly like the others and was administered by his brother and sister. [R. 32.]

Each trustee was empowered to distribute income as follows [R. 38]:

> In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation.

Thus, a trustee in the exercise of his "discretion" in paying out income could do so only with the proposition firmly fixed in his mind that if he ever wanted anything from his trust, he must apply to the beneficiary whose request was under consideration.[2] Nor is it possible that

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[2]In this connection it is submitted that taxpayers are in error in arguing (Br. 34) that as secondary beneficiaries of the trusts the family members when acting as trustees would have an interest adverse to that of the chief beneficiaries. There is nothing in the record to show that this secondary interest would overcome a trustee's primary interest as chief beneficiary of one of the reciprocal trusts.

there would be much difficulty under the circumstances in convincing a trustee that one needed the distribution for his proper "support, maintenance, comfort, education and *recreation.*" (Emphasis supplied.) *Cf. Merchants Bank v. Commissioner,* 320 U. S. 256.

Moreover, after the limited partnership had replaced the wholly owned corporation as the family method of doing business, each trust was made a limited partner under an agreement expressly making the interests of limited partner non-assignable. [R. 34-35; Ex. 1-E, R. 69.] Consequently, although the trustees of the various trusts had unlimited power of investment [R. 37], the corpus was immediately and according to a pre-arranged plan [R. 32-33], inextricably invested in the family business, adding to the cumulative inference that the "trustees" were never intended to be fiduciaries at all. Additionally it is also worthy of note that no separate books were kept for the trusts by the "fiduciaries," all trust transactions being reflected only on the books of the family partnership. [R. 33.]

The scheme was obviously one with a built in guarantee that each beneficiary could either receive the income or allow it to accumulate and be required to pay taxes only on the amount actually received. It is submitted that the scheme itself was so transparent a form of tax avoidance that the District Court would have been justified in holding the trust illusory without more.

The inference that the trusts were intended to have validity only for tax purposes is unmistakable. However, this conclusion need not rest solely on logical inference and reasonable assumption for subsequent events proved

it conclusively. The trust instrument provided that accumulated income for period A (March 3, 1944, to January 2, 1950) "shall be distributed to the beneficiary hereof on the 2nd day of January, 1950." [R. 37.] Despite this express direction, the trust income was never distributed but was retained in the partnership. [R. 39.] Moreover, even after the partnership exchanged its assets for stock in a newly formed corporation and the corporation consistently lost money and subordinated its common stock to preferred, the trustees made no move to withdraw the trust funds. [R. 43.] The trustees neither exercised any independent fiduciary judgment nor did they even follow the express directions of the trust instrument.[3]

Contrary to taxpayer's suggestion (Br. 45), the District Court has not departed from established precedent in this case. As we have indicated it is well settled that a beneficiary of a trust who has the right to receive income from the trust in the amounts and at the times he desires is taxable with the trust income whether it is actually distributed or not. *Grant v. Commissioner,* 174 F. 2d 891 (C. A. 5th); *Bunting v. Commissioner,* 164 F. 2d 443 (C. A. 6th); *Emery v. Commissioner,* 156 F. 2d 728 (C. A. 1st), certiorari denied, 329 U. S. 882; *Stix v. Commissioner,* 152 F. 2d 562 (C. A. 2d); *Mallinckrodt v. Nunan,* 146 F. 2d 1 (C. A. 8th), certiorari denied, 324 U. S. 871; and *Frank v. Commissioner,* 145 F. 2d 413 (C. A. 3d); Treasury Regulations 111, Section

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[3]Taxpayers' objection (Br. 14) to the materiality of this evidence is not well founded. While the subsequent facts may not prove that there was a right to receive income in the years in question here it is clear that they establish that the inference that there was in fact no bona fide trusts is correct. These facts merely serve to check on and confirm the correctness of this inference—a safeguard not always available.

29.22(a)-22, Appendix, *infra*. The underlying principle of these cases is succinctly stated in *Emery v. Commissioner, supra* p. 730, as follows:

> We cannot see any valid reason for distinguishing between a settlor who reserves broad powers over a trust and a beneficiary who receives and retains such powers. The fact that the petitioner did not exercise her powers in her own favor during the taxable years does not make the income any less taxable to her. *Stockstrom v. Commissioner,* 8 Cir., 1945, 151 F. 2d 353, 356. In enacting §22(a) of the Internal Revenue Code, Congress intended "to use its constitutional powers of income taxation to their 'full measure'." *Helvering v. Stuart,* 1942, 317 U. S. 154, 168, 169, * * * It is not necessary that a taxpayer collect the income which is attributable to him for the purposes of income taxation. *Helvering v. Horst,* 1940, 311 U. S. 112 * * *; *Helvering v. Eubank,* 1940, 311 U. S. 112 * * *; *Helvering v. Clifford,* 1940, 309 U. S. 331 * * *. Where his control of a trust is so complete that it must be said that the taxpayer is the owner of the trust's income, then it is taxable to him. *Helvering v. Stuart, supra.*[4]

Flato v. Commissioner, 195 F. 2d 580 (C. A. 5th), presented a factual situation strikingly similar to the one at bar. There a share of two family partnerships was transferred in trust for the benefit of three sons, Franklin, Frederick and Robert. In all six trusts were created, two for each son. Franklin was made trustee of the two trusts for Frederick; Frederick was trustee for the two

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[4]Indeed, following this rationale, grantors of reciprocal trusts have been held taxable on the income thereof. *Lehman v. Commissioner,* 109 F. 2d 99 (C. A. 2d), certiorari denied, 310 U. S. 637.

trusts for Franklin; and Franklin and Frederick were co-trustees of the two trusts for Robert. The trusts were all similar and gave the Trustees power to retain and reinvest the income or they could make distribution of both principal and income at their discretion. The trusts were irrevocable and for a ten year term. The Commissioner contended that the creation of the trusts was a mere sham and artifice and was solely an attempt to divide the partnership income six ways instead of three and that under the actualities of the case the trust income was taxable to the three brothers as partners under Section 22(a) of the Internal Revenue Code of 1939. Both the Tax Court and the Court of Appeals agreed with the Commissioner's view. The Court of Appeals pointed out that the Tax Court was justified in considering the results rather than the mere language of the instruments and concluded that the Tax Court's finding that the beneficiaries could have what they wanted of trust income was supported by the evidence and justified disregarding the trusts and taxing the sons with partnership income.

Taxpayers seek to lessen the impact of the *Flato* case by arguing (Br. 28-30) that that decision rested on the fact that there were actual distributions made to the sons, whereas in this case there were no distributions to taxpayers. However, the opinion in that case does not seem to be so limited, for the entire income of the trusts, whether distributed or not, was taxed to the sons, and the Court of Appeals noted (p. 582):

> It is well established, of course, that where income is subject to one's unfettered command and he is free to enjoy it at his own option, he may be taxed on such income whether he elects to enjoy it or not. *Corliss v. Bowers,* 281 U. S. 376. * * * This principle is not limited to the grantor of a trust, but

is equally applicable to the beneficiary of a trust. *Bunting v. Commissioner of Internal Revenue,* 6 Cir., 164 F. 2d 443; *Grant v. Commissioner of Internal Revenue,* 5 Cir., 174 F. 2d 891.

Taxpayers also argue (Br. 24 *et seq.*) that one cannot be held to be the owner of trust corpus or income unless the trust instrument gives him express power over the corpus or income. It is submitted that this argument is merely that the form of the transaction shall control and unless the invalidity of the trust clearly appears on the face of the instrument it must be upheld. Such a rule is simply not recognized. In *Doll v. Commissioner,* 149 F. 2d 239, 244 (C. A. 8th), certiorari denied, 326 U. S. 725, in a family partnership case the court discussed the *Clifford-Horst* line of cases as they apply to intra-family arrangements at length and concluded:

> We have here a written instrument which is sufficient to create a partnership, both at common law and under Missouri decisions. * * * The judgment here is at most an adjudication of what was never in doubt. The existence of such a contract is not determinative of this tax issue. There remains the impact of the test of an analysis of "all the circumstances attendant on its creation and operation." *Helvering v. Clifford,* 309 U. S. 331, 335, * * *. This test must be applied in view of the statutory scheme of taxation prescribed in §22(a), *Clifford* case, 309 U. S. at page 334, * * * and under the special scrunity arising from the situation that only a husband and wife are parties to the contract. *Clifford* case, 309 U. S. at pages 335-337 * * *. The question posed for this analysis is whether this

> contract caused "any substantial change in his [petitioner's] economic position." *Clifford* case, 309 U. S. at page 336 * * *. The answer is to be found in the pertinent facts. Determination of such fact situation is the exclusive province of the Tax Court and its decision must be upheld if based on substantial evidence.

See also *Paster v. Commissioner,* 245 F. 2d 381 (C. A. 8th), certiorari denied, 355 U. S. 876; and *Trousdale v. Commissioner,* 219 F. 2d 563 (C. A. 9th).

In summary, this case represents an admitted attempt to reduce taxes by having taxpayers hold part of their share of the family business in trust instead of outright. The reciprocal status of beneficiaries and trustees, the intimacies of the family setting, the complete disregarding of fiduciary duties, and the entire circumstances surrounding the transaction clearly justified the determination by both the Commissioner and the District Court that the trusts were illusory. As the Fifth Circuit aptly stated in the *Flato* case, *supra,* p. 582:

> The incidence of taxation may not be avoided by mere "legal paraphernalia which inventive genius may construct," *Helvering v. Clifford,* 309 U. S. 331 * * * but the Court must look to the "whole nexus of relations between the settlor, the trustee and the beneficiary", *Helvering v. Elias,* 2 Cir., 122 F. 2d 171, 172, and if it concludes that in spite of the form resorted to in effecting a transaction, the results thereof give the beneficiary command over the distribution of the income of a trust, such income is taxable to the beneficiary.

Conclusion.

For the above reasons, the judgments of the District Court are correct and should be affirmed.

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APPENDIX.

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1 and 3, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

Sec. 161. Imposition of Tax.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

*   *   *   *

(b) *Computation and Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

*   *   *   *

(26 U.S.C. 1952 ed., Sec. 161.)

Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for

the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

* * * *

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(26 U.S.C. 1952, ed., Sec. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-22 [as added by T.D. 5488, 1946-1 Cum. Bull. 19]. *Trust income taxable to person other than grantor.*—

Where a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person. Even though such a power has been partially released or otherwise modified as that the person holding it can no longer vest the corpus or the income of the trust in himself, the income shall continue to

be taxable to such person if, after such release or modification, he has retained such control of the trust as would, within the principles of section 29.22(a)-21, subject a grantor of such a trust to tax on the income thereof. This section shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor is otherwise taxable under section 29.22(a)-21. See also section 29.166-2.

Section 22(a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section.